NO. 50641-6-II

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

Aventis Pharmaceutical, Inc. and Sanofi-Aventis US, LLC,

Appellant,

v.

Washington State, Department of Revenue,

Respondent.

APPELLANTS' REPLY BRIEF

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I. INTRODUCTION

Can a state agency add words to a tax-imposing statute to exclude an entire class of wholesalers from claiming a preferential B&O tax rate? The parties are before this court because the trial court answered yes. The appellants, Aventis Pharmaceuticals, Inc. (a.k.a. Aventisub LLC) and Sanofi-Aventis US, LLC, (hereafter collectively referred to as "Sanofi") reply to the Department of Revenue's (hereafter, "Department") response to the appellants' opening brief.

The issue before this court is whether the words of the statute RCW 82.04.272 support the narrow interpretation advanced by the Department or the broader meaning advanced by Sanofi. The parties agree that Sanofi is a "qualified seller" within the meaning of the statute. The disagreement is over whether the statute poses an additional requirement regarding Sanofi's direct buyers. The Department's interpretation would disqualify most of Sanofi's sales from RCW 82.04.272 because Sanofi's direct buyers are not licensed as retail pharmacies. However, there is no mention of a pharmacy license anywhere in the statute. The statute only refers to the "pharmacy assurance quality commission." This commission issues pharmacy licenses, but other licenses as well, including ones issued to Sanofi's buyers.

Both parties argue that the statute is clear on its face but reach

different results. Sanofi contends that (1) the Department does not correctly interpret the statute; (2) if the statute is ambiguous, then the legislature's intention should prevail; and (3) finally, the trial court order renders the statute unconstitutional.

Sanofi's buyers meet the statutory requirement, but the Department disagrees, noting Sanofi's buyers only hold themselves out as wholesalers. The Department asserts that only sales made by a taxpayer directly to a "licensed retail pharmacy" are covered by the statute. The statute, however, states that the lower rate applies broadly to those taxpayers engaged in the activity of "buying ... and reselling" prescription drugs. Further, the statute anticipates that sales, commencing with the "manufacturer" made to a "wholesaler" and possibly to "***another wholesaler***" leading up to a retail sale. (Emphasis added.) Each of these transactions occurs to facilitate the consumer's purchase "pursuant to a prescription." The statute describes the entire chain of sales necessary to bring drugs to consumers, so that all the intervening transactions are eligible for the reduced rate.

Further, Sanofi's indirect customers are retail pharmacies and the consumers buying pursuant to a prescription. The statute defines "wholesaling" as the "buying... and reselling" of drugs. This language anticipates consecutive transactions, possibly between multiple

wholesalers, all culminating in a sale to a retailer. Thus, if a retailer is Sanofi's indirect customer the "retailer" requirement is also satisfied.

Nonetheless, even if this court were to adopt the Department's narrow interpretation, then Sanofi's sales to its three main buyers would *still* qualify for the lower rate. These customers not only wholesaled, but they also made sales at retail. CP 39, ¶ 24; CP 41, ¶ 28.b; and CP 42, ¶ 33. Two of the buyers stated that they reported income on the retailing B&O tax line of the combined excise tax return. CP 72-73 and 76-77.

Sanofi also contends that if the statute is found to be ambiguous, then the court should look to the legislative intent. The parties do not dispute that the purpose was to put in-state wholesalers on a competitive footing with out-of-state wholesalers that were not required to pay the Washington wholesaling B&O tax. Sanofi contends that the legislature intended all wholesalers to benefit from the tax relief, not only the last distributor. Because keeping drug wholesalers competitive is the key legislative purpose. As discussed below, it would make no sense to force upstream distributors to pay the higher rate, because they would include the tax in the cost of goods they sell, forcing that increased cost to the last wholesaler. Imbedding these additional tax costs only makes the last distributor less competitive with the out-of-state competitors that do not bear that cost.

Finally, the Department asks this court to disregard the constitutional question as not timely raised, and even if the court hears the issues, the Department's interpretation does not infringe on the constitutional provisions raised by Sanofi with the trial court's decision. It is inescapable that the Department's interpretation adopted by the trial court requires Sanofi to be taxable based upon another's actions, not upon its own actions, and that is a very serious infringement of the constitution.

II. ARGUMENT

a. RCW 82.04.272 is unambiguous and Sanofi meets every requirement for the statute to apply to it.

The statute requires that Sanofi be a qualified wholesaler under RCW 82.04.272, and the Department agrees that Sanofi is a qualified wholesaler. Respondent's Br. at 9. So, the parties agree to that extent.

The parties differ as to what characteristics Sanofi's buyers must possess. Sanofi argued that the statute's words allow the "retailer" classification to be met by indirect customers in the stream of distribution. The wholesaler classification applies to sales within the chain of distribution. The Department contends that only the last distributor to sell to a retailer qualifies. Respondent's Br. at 14-17. Sanofi argues that application is incorrect for the following reasons.

1. The Department incorrectly contends that Sanofi's buyers did not meet the buyer's requirement, because the buyers did not make sales at retail.

The Department argues that Sanofi's buyers did not meet the buyer's requirement because they were not retailers, a status that the Department contends may only be proven by holding a retail pharmacy license, although those words do not appear in the statute. *See* Respondent's Br. at 9-13.

The Department's contention that the buyers only met the wholesaling function is a partial view of the record. Respondent's Br. at 13. However, the buyers did more than wholesaling. According to the buyers' 10-K annual filings with the United State Security and Exchange Commission, they did make retail sales. Appellant's Br. at 11; CP 39-40,¶ 24.a; CP 41, ¶ 28.b.; CP 42, ¶ 33. Further, in another RCW 82.04.272 case, two buyers' filed declarations that they filed combined excise tax returns, reporting the retailing B&O tax. Appellants' Br. at 12; CP 40; ¶ 24.b; and CP 41, ¶ 28.c).

Consequently, there *is* evidence in the record that Sanofi's buyers made sales at retail; there is no evidence in the record that rebuts the assertion that these buyers made retail sales.[1] Thus, the court could resolve

[1] The Department casts doubt on whether Sanofi's buyers reported retailing B&O tax. See Respondent's Br. at 21, footnote 9. However, the Department has provided no evidence that they did not. The Department received those filed tax returns and knows

this matter by reference to the record, because it contains evidence that supports the conclusion that these buyers made sales at retail.

i. The reduced rate in the statute applies to the person, meaning the seller, not on a sale-by-sale basis, as the Department contends.

To support its position that Sanofi does not qualify for RCW 82.04.272, the Department describes the B&O tax classification statutory scheme. Respondent's Br. at 6 and 7 and at 11 (stating that RCW 82.04.272 applies only to sales to buyers who sell at retail). This would require a separate tracking of each sale by Sanofi through the entire chain to determine whether the wholesaler may claim the reduced rate as to each unit sold. RCW 82.04.272(1), however, specifically provides that the reduced rate applies to the taxpayer, and not to the sale. It reads:

> *Upon every person* engaging within this state in the business of warehousing and reselling drugs for human use pursuant to a prescription; *as to such persons*, the amount of the tax shall be equal to the gross income of the business multiplied by the rate of 0.138 percent. (Italics added.)

Thus, the statute clearly applies the lower rate on an entity-by-entity basis, and not sale-by-sale. It is all or nothing as to the

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whether these taxpayers reported retailing B&O tax. Furthermore, as three buyers at issue in this case are very large and, likely, have been audited, someone in the Department could confirm without disclosing confidential tax information whether these entities paid retailing B&O tax on their prescription drug sales, especially in light of the fact that the 10-K forms state that they each made retail sales. Contrary to the Department's footnote, it is not the "barest amount of information" but corroborating evidence with the 10-Ks that they made retail sales.

taxpayer. In fact, there is no mention at all in the statute of the word "sale." The notion that the rate is applied on a sale by sale basis has no support in the words of the statute. The rate applies to "every person" that is a "wholesaler."

The statute makes no distinction between wholesalers, although the Department's reading would force the creation of two distinct classes. There is no support in the words of the statute to differentiate between wholesalers, making only one group eligible for the reduced rate to the exclusion of the other. In other words, all activities described in RCW 82.04.272 are treated as one tax-classified activity, eligible for the .138% tax rate.

This is not unique in the B&O tax scheme. For example, RCW 82.04.260(11) provides that manufacturing, wholesale selling, or retail selling constitutes a single tax classification:

> ... upon every person engaging within this state in the business of *manufacturing* commercial airplanes, or components of such airplanes, *or making sales, at retail or wholesale,* of commercial airplanes or components of such airplanes, manufactured by the seller, as to such persons the amount of tax with respect to such business is ...[tax measure] multiplied by the rate of ... 0.2904 percent. (Italics added.)

Again, manufacturing, selling at retail or wholesale are taxable in one

classification at the rate of .2904%. That principle can be found again in slaughtering and selling perishable meat products, printing/publishing newspapers, and printing/publishing or newspapers: all are treated as a single, taxable class of activity.[2]

Accordingly, Sanofi's interpretation of RCW 82.04.272 is not unique. RCW 82.04.260(11) is another statute where the legislature chose to apply a single rate uniformly to one class whether the selling occurred by a manufacturer, wholesaler to another wholesaler, or selling to a retailer. The legislature intended all activities to be identically taxed.

For these reasons, Sanofi disagrees that the wholesale-to-wholesale versus wholesale-to-retail dichotomy drives the interpretation of RCW 82.04.272. The legislature created a single rate of tax for taxpayers in the "business of warehousing and reselling drugs for human use pursuant to a prescription." There is no disagreement that Sanofi does such activity.

Sanofi is entitled to the single rate that applies to warehousing and reselling prescription drugs. It is unnecessary to add a retail pharmacy license requirement into the wording in order to interpret this statute properly. The Department's interpretation is only viable if another qualifier were added to the existing language, changing the meaning of the

[2] See RCW 82.04.260(4),82.04.260(14)(a), and RCW 82.04.280(1)(a).

statute by introducing a dichotomy of wholesalers not found in the words of the statute itself.

ii. The Department incorrectly contends that the legislature intended RCW 82.04.272 to apply to only the last distributor is wrong.

The Department contends that the legislature intended RCW 82.04.272 to apply only to the last wholesale distributor selling to retail pharmacies. Respondent's Br. at 14. According to the Department, the legislature "intended to limit the application of the preferred rate to a *subset* of prescription drug wholesalers...." *Id.* (Italics in original.) Sanofi agrees with the Respondent that the court should give effect to the statute as a whole. Respondent's Br. at 15. But, the Department's interpretation fails to do that by creating a requirement for a retail pharmacy license. The legislature shows no intent to create a subset of sellers within the universe of drug wholesalers.

The legislature did not intend to create two "subsets" of wholesalers. As the Department notes, the legislature intended to help in-state distributors compete with out-of-state businesses.[3] Respondent's Br. at 7. However, the Department does not explain how its interpretation furthers *that* purpose by limiting RCW 82.04.272 to only the last

[3] None of the committee reports mentions the last wholesale distributor; they only mention instate wholesalers. *See generally*, CP 130 – 138. The legislative reports speak nothing of a subset of distributors.

wholesale distributor. In fact, the Department's position does the exactly the opposite.

The following example illustrates how the Department's interpretation fails to achieve the legislature's purpose. If Sanofi pays B&O tax rate of .484% (the normal wholesaling rate), then it will pass that cost on to the AmerisourceBergen so that it can maintain its profit margin.[4] Because that tax cost is passed through to its buyer, AmerisourceBergen will be impacted, because not only will it include its rate of .138% in its buyer's drug cost, but it will also need to include Sanofi's tax at the .484% rate that has been bundled into its cost of the prescription drugs. Because Washington's B&O tax pyramids (paying tax on tax),[5] the more times upstream wholesalers are taxed at .484% to different upstream distributors, the higher its cost of the prescription drug will ultimately be to AmerisourceBergen. With tax pyramiding occurring, AmerisourceBergen is less competitive than the out-of-state sellers that do

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[4] Overhead is simply the aggregate cost of doing business. By saying "such taxes shall constitute a part of the operating overhead," the legislature simply considers the B & O tax a cost of doing business. RCW 82.04.500. *Nelson v. Appleway Chevrolet, Inc.*, 160 Wn.2d 173, 180, 157 P.3d 847, 850 (2007)

[5] "Pyramiding of taxes is the payment of taxes by different companies on the same goods or services. This occurs when goods or services of one company are inputs for another's production and/or sales. Thus, a tax is paid multiple times on a product as it moves through the production chain." Tax Alternatives for Washington State: A Report to the Legislature, at 24. See Appendix. https://dor.wa.gov/sites/default/files/legacy/Content/AboutUs/StatisticsAndReports/WAtaxstudy/Volume_1.pdf

not have the pyramiding problem.[6]

If the Department is correct -- that the goal is *only* to make the last instate distributor competitive -- then its interpretation fails to further the legislature's goal. Increasing the costs of upstream competitors will impair the last distributor's cost competiveness. In fact, it can have such a detrimental effect that it may well encourage the retailer to purchase from out-of-state distributors not subject to Washington B&O tax. That is exactly the harm to instate sellers that the legislature wanted to eliminate.

The tax cost is rather staggering. According to the testimony at the House Finance Committee, a witness said that "[t]he B&O tax averages roughly 25 percent of the profit of Washington firms." CP 133. By allowing the higher tax cost on upstream wholesalers coupled with the pyramiding B&O tax, that tax cost could be even greater than 25%[7] to the last distributor when all taxes are aggregated.

Rather than helping the last distributor in the chain, the Department's interpretation actually puts the last wholesale distributor in the same place it was by before the legislature adopted RCW 82.04.272,

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[6] According that 2002 study, the B&O pyramids on average 2.5 times but the range is from 1.4 to 6.7. Wholesalers see pyramiding at the rate of 1.9 and retailers at the rate of 1.6 times. Tax Alternatives for Washington State: A Report to the Legislature, Appendix C-1, Table 1 at 40. See Appendix.
https://dor.wa.gov/sites/default/files/legacy/Content/AboutUs/StatisticsAndReports/WAtaxstudy/Volume_2.pdf

[7] The exact pyramiding tax cost could be only be determined by how many upstream wholesale sellers were in the line of distribution.

encouraging retailers to seek drug supplies from out of state. Here, the legislative history is contrary to the Department's position; the legislature intended to help in-state drug wholesalers without regard to whether the distributor was the last distributor, not to create out-of-state winners and in-state losers.

2. The Department's explanation for adopting the retail pharmacy license might be convenient administration, but it is not persuasive as law.

The Department has explained why it adopted the retail pharmacy license option. Respondent's Br. at 23. It notes that the Department considered five options. *Id.* and CP 165-167. Clearly, these five options were possible interpretations of the statute, or the Department would not have identified them as options.

It rejected the position advanced by Sanofi, because "In other words, we were unwilling to exclude sales to distributors as a class, without more." CP 166. It eventually settled upon the retail pharmacy license, because it avoided "putting excessive burdens on taxpayers, downstream distributors, and the Department." CP 166. The Department then imposed the retail pharmacy license in Excise Tax Advisory 3180.2013 (ETA 3180). CP 167.

Two important points should be kept in mind. One is that an Excise Tax Advisory has no force of law. Second, nothing in Mr.

Brewer's declaration states that the public input was considered in adopting ETA 3180. CP 162 – 168. The ETA adoption did not follow the APA procedure that would have solicited public input to provide the "more" that he said the Department needed to adopt that option.[8] So, rejecting Sanofi's interpretation was arbitrary and capricious at best.

Further, the option to require a retail pharmacy license was not chosen solely because it was the most correct answer. According to the Department, but it was chosen because of the administrative convenience to avoid "excessive burdens". CP 166. Taxpayers would no doubt appreciate that sentiment if all options were equal, and the Department chose the one that was administratively more convenient. However, they are not all equal, and the Department did not reject the other options because they were known to be incorrect. *Id.* Instead, it appears that they were rejected as failing to be the most administratively convenient.

The legal problem with limiting the scope of the statute to direct sales to retailers is that it is an arbitrary decision not supported by any language in the statute and it excludes coverage to other sales without any

[8] It is not fair to say now that the Department had a process to determine the meaning of RCW 82.04.272; it only talked staff from the Department and from the Pharmacy Board to arrive at that policy. Had the Department conducted a rule hearing, it might have heard the "more" arguments with respect to why Sanofi's arguments are correct. The only notification to the public, it appears, is when it filed the notice of the interpretative statement with the Code Reviser on September 25, 2013 and posted drafts of ETA 3180 on its website and mailed copies to its listserv. CP 167. It is noteworthy mind that this ETA was published *nine months after Sanofi filed its refund request* on December 26, 2012. Appellant's Br. at 15.

rationale or legal underpinning.[9] Appellants' Br. at 26-27. There is nothing in RCW 82.04.272 that would allow such a narrow, exclusionary interpretation to stand. Thus, the Department's view expressed in ETA 3180 is flawed and should be rejected.

b. If this court finds RCW 82.04.272 is unambiguous, then Sanofi's interpretation should prevail.

Sanofi argued that if a statute is ambiguous, then the rules of construction require that a tax-imposing section be interpreted in a manner that is deferential to the taxpayer. Appellants' Br. at 28-44. Sanofi cited to *Weyerhaeuser Co. v. State Dep't of Revenue*, 106 Wn.2d 557, 723 P.2d 1141(1986) to support that proposition.

The Department rejects that case as factually different and concludes that it lacks persuasion. Respondent's Br. at 27. It is true that *Weyerhaeuser* presented the question of whether the Department could impute income, and that is not the issue here. However, *Weyerhaeuser* is not limited to its facts; it applies to any tax-imposing section. In applying this principle, the court relied on *MAC Amusement Co. v. State Dep't of Revenue*, 95 Wn.2d 963, 633 P.2d 68 (1981); *Duwamish Warehouse Co. v. Hoppe*, 102 Wn.2d 249, 684 P.2d 703 (1984). Both cases interpreted the

[9] Although not mentioned in the Appellants' Brief, Sanofi could be making retail sales to out-of-state pharmacies that do not have to be licensed by the Washington State Board of Pharmacy (particularly along this states' borders).

meaning of the leasehold excise tax; no imputation was involved. The distinction drawn by the Department is a distinction without a difference.

The Department also questions why the legislature would have provided a lengthy definition of "warehousing and reselling drugs for human use pursuant to a prescription." Respondent's Br. at 29. If Sanofi's interpretation is correct, then what was the purpose of the definition? *Id.* Perhaps, though not "elegant prose" as the Department points out (Respondent's Br. at 26), the legislature may have tried to be more inclusive with the definition by describing all of the activities that should fall under RCW 82.04.272, commencing with the sale by the manufacturer and ending with the consumer's purchase pursuant to a prescription. That language need not be viewed as limiting language.

However, the court does not need to speculate about whether the Department or Sanofi has the correct interpretation. As Sanofi previously explained on page 9, *supra*, the legislature's committee reports make no distinction between wholesalers in RCW 82.04.272. Instead, the legislature viewed them as a single tax classification. Its purpose was to make instate wholesalers competitive with out-of-state wholesalers, to segregate them into winners and losers. The Department's interpretation, for reasons explained, beginning on page 9, *supra*, could make RCW 82.04.272 ineffectual if the upstream wholesalers are required to pay the

higher B&O tax, encouraging the retailers to go back to buying their prescription drugs from out-of-state sources as they did prior to the adoption of RCW 82.04.272.

Sanofi also argued that applying the Department's interpretation would have the result of increasing drug costs. Appellants' Br. at 32. The Department contends that would not be the most effective way to reduce costs; the legislature has already done that with the sales tax exemption. Respondent's Br. 32. Sanofi does not disagree that the sales and use tax exemption has a substantial impact on cost. But that does not diminish the cost issue. As the testimony before the legislative committees stated, the wholesaling B&O tax cost at .484% constituted 25% of the wholesaler's net profit. *See* discussion on beginning on page 9, *supra*. This is a significant cost that is reduced by adopting Sanofi's interpretation and rejecting the Department's last wholesale distributor interpretation.

c. Sanofi's constitutional claims are ripe and should be reviewed.

Sanofi contends that the trial court's finding creates constitutional questions. Appellants' Br. at 38. The Department responds that the issue is untimely, citing to RAP 2.5(a)(3) that provides circumstances when a constitutional issue can be raised at the first time on appeal. It asserts that

the prerequisites for review are not present. The court has authority under RAP 2.5(a)(5) to hear these constitutional questions.

The Department objects to this court reviewing whether the ruling has due process infirmities. Respondent's Br. at 35. It observes that the appellate courts do not consider issues for the first time if it is simply "[n]aked castings into the constitutional seas are not sufficient to command judicial consideration and discussion." *Pub. Hosp. Dist. No. 1 of King Cty. v. Univ. of Washington*, 182 Wn. App. 34, 49, 327 P.3d 1281, 1289 (2014). It is important to understand that Sanofi is not offering "a naked casting" in claiming serious constitutional issues; it has demonstrated why its assertion is not meritless and rises to the question worthy of this court's consideration.

Unlike the appellant in *Pub. Hosp. Dist.*, Sanofi is not simply citing to a provision of the constitution, and then asking this court to consider whether the trial court's ruling violated the constitution. Rather, Sanofi has explained why the trial court's ruling that requires Sanofi to trace the selling activities of its buyers would be constitutionally infirm, relying on the Washington State Supreme Court's decision in *Dot Foods, Inc. v. Washington Dep't of Revenue*, 166 Wn.2d 912, 215 P.3d 185 (2009). Appellants' Br. at 38-40.

The constitutional question for this court is whether the trial court's ruling can constitutionally require Sanofi to trace the sales through its buyers in order to prove its entitlement to a tax classification (in other words, prove that its buyers sold the prescription drugs at retail). The record demonstrates that the Department itself found the tracing requirement to be unacceptable, rejecting that as an option in its interpretation of RCW 82.04.272, stating:

> *11.* The question was how to determine which sales by a taxpayer to a distributor, if any, might qualify the taxpayer for the prescription drug warehousing rate. One way was to require that taxpayers collect information from downstream distributors about the distributors' customers, and the volume of those sales. The portion of those sales to the distributors' customers that were sales to patients and other consumers in pharmacies, retail facilities, or by mail order or online sales, would represent the taxpayer's sales to distributors that qualified as sales to "persons selling at retail." If adopted, this option would have placed significant burdens on taxpayers to collect information that distributors and their customers might consider proprietary and confidential. Also, it would have placed administrative burdens on the Department to review and evaluate such information in routine audits and appeals. *We rejected this option.* (Italics supplied.)

CP 166.

Consequently, the Department admits that tracing sales through the subsequent buyers is unworkable, *and it rejected that option.* Sanofi

agrees that not only was this option unworkable, but it argues that it is also unconstitutional. The court should understand that both the Department and our courts are bound by RCW 82.04.4286:

> In computing tax there may be deducted from the measure of tax amounts derived from business which the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States.

The legislature clearly requires the Department and our courts to construe the B&O statutes through the prism of constitutionality. The court needs nothing more from the record to make this determination.

This point is critical, because as the Department observes, the court should not review a constitutional claim under RAP 2.5(a)(3) unless the error is "manifest." Respondent's Br. at 36. "If the record from the trial court is not sufficient to determine the merits of the constitutional claim, then the claimed error is not 'manifest.'" *Id.* Here, as set forth above, the record is sufficient to determine the merits of Sanofi's claim that the trial court's order violates due process as explained under *Dot Foods*. This is true because the trial court's order determines Sanofi's tax classification based upon what its buyers do with the prescription drugs. Furthermore, as stated by the Department, it is impractical to require that tracing. For example, if Sanofi sold the prescription drugs in January of 2018, then it

would be required to report that sale to the state in February of 2018. That prescription drug might be held in inventory and not resold until May of 2018. How would Sanofi know what tax classification applied in February of 2018 if it did not, or could not know, how its buyer distributed the prescription drugs in the future in May of 2018? The simple answer is that it is impossible. This is why tracing is a constitutional problem, because the taxpayer's tax-reporting obligations are vague and unascertainable at the time the tax is due if the taxpayer cannot know its obligations until some event by another that occurs in the future.

The Respondent contends that ETA 3180 addresses that problem by its use of a proxy for retailing; requiring the buyer to have a retail pharmacy license. Respondent's Br. at 36. However, as explained above on pages 13-14, a retail pharmacy license does not assure that all retail sales are captured by the retail license, because there are circumstances when a wholesaler without a retail pharmacy license could be making retail sales. Appellant's Br. at 26-27. Thus, ETA 3180 should fail because it is crafted too narrowly by excluding retail sales that can be made without a retail pharmacy license.

The Respondent agrees that the *Dot Foods* opinion did not provide much analysis when it found that the Department's interpretation violated

the Due Process Clause. However, that does not make it wrong. The agreement was important to its holding and not merely dicta:

> ... We agree with this [due process] analysis. Under the statutory provision, the Department cannot hold Dot responsible for taxes *on sales it essentially has nothing to do with*. The statute's plain language pertains to a requirement that an out-of-state seller "[m]akes sales in this state exclusively to or thorough a direct seller's representative." (Italics supplied.)

Dot Foods, at 923 and 190. The language could not be clearer and this court should follow the direction until our state Supreme Court decides to clarify or overrule it.

d. Limiting RCW 82.04.272 to only wholesalers that make sales to retailers violates the Equal Protection Clause.

The Department argues that its limitation of RCW 82.04.272 does not violate the Equal Protection Clause. Respondent's Br. at 40-46. In its argument, the Department believes that additional pre-trial discovery of downstream sales would be necessary to determine whether the court's order violated the constitution. Respondent's Br. at 40. Sanofi disagrees. The record is sufficient to determine whether the Department's interpretation permissibly creates two types of wholesalers: ones that sell to other distributors that do not hold the retail pharmacy license and ones that do. Clearly, the facts of this case establish that there are two classes

of wholesalers, because the Department denied Sanofi's refund claim as a wholesaler that could not prove that its buyers held retail pharmacy licenses. The record is complete and sufficient to determine if the trial court created an impermissible "subset" of distributors (as the Department argues; *see* Respondent's Br. at 14) or if there is but one classification of prescription drug wholesalers as Sanofi contends.

The Department relies heavily on its premise that statute created only one subset class: wholesale prescription drug wholesalers that sell to retailers that hold a retail pharmacy license. Respondent's Br. at 44. However, that is not what the record demonstrates. The statute is not clear that it created one class; otherwise, the Department would not have had to consider five options (including the theory that Sanofi has advanced). Respondent's Br. at 23-24; CP 166-167. Furthermore, the legislative committee reports signal no intention to create a "subset" of wholesalers. In fact, the committee reports describe helping instate drug wholesalers --- without any qualification. See Appellants' Br. at 34-38; CP 130-138. Thus, the fact that the Department viewed Sanofi's theory as a possible option coupled with the legislative history being totally devoid of a retail pharmacy license, the Department's position is without factual foundation.

Sanofi explained how *Associated Grocers Inc. v. State*, 114 Wn.2d 182, 787 P.2d 22 (1990) supports its claim that the Department's

pharmacy license violates the Equal Protection Clause. Appellants' Br. at 42-44. In the Department's first effort to distinguish its application from *Associated Grocers*, it relies on its position that a "subset" of wholesale prescription drug wholesalers was legislatively intended. Respondent's Br. at 43. For the reasons expressed above, there is no factual support for that position in the record when the Department was crafting ETA 3180. Clearly, there is no support in the legislative committee reports.

The Department addresses the second part of the Equal Protection analysis, contending that there is a rational basis for the pharmacy license. Respondent's Br. at 44. The pharmacy license might have rational basis if the legislature had included it in the statute. However, it did not. The Department added that requirement because it was administratively easier to do so. CP 166. To the contrary, every legislative indication is that *any* prescription drug wholesale in the chain of distribution would fall under RCW 82.04.272. CP 130-138.

Finally, the Department addresses the third part of the Equal Protection analysis regarding the relationship of the challenged classification; the "subset" of prescription wholesalers the sell to retailers holding a retail pharmacy license. There is no rational basis to treat one wholesaler differently from another. In fact, as discussed above, the Department's interpretation actually distinguishes between retailers based

on whether the retailer holds a retail pharmacy license even though a reseller can make retail sales without the retail pharmacy license. *The retail pharmacy license does not assure that a sale without a retail pharmacy license was not retail sale.*

Furthermore, creating the "subset" class does not further the legislature's intent to reduce the tax cost on the class of prescription drug wholesalers when instate wholesalers that compete with out-of-state wholesalers are taxed differently, which is the result from the Department's interpretation. And the Department's interpretation does not further the legislature's purpose if only the last wholesale distributor gets the benefit of RCW 82.04.272, because of the pyramiding feature of the B&O tax. *See* page 10, *supra.*

The Department argues that a classification that treats prescription drug wholesalers differently does not necessarily offend the Equal Protection Clause. Sanofi does not dispute that legal principle. However, it is the legislature's prerogative to make that classification by statute, not the administrative agency's prerogative to do so.

III. CONCLUSION

Sanofi was entitled to summary judgment. It has demonstrated that it has met the statutory requirements to fall within the scope of RCW 82.04.272. If this court finds that RCW 82.04.272 is ambiguous, then it

should look at the legislative history to determine whether the legislature intended to RCW 82.04.272 to distinguish between wholesalers and bestow the lower rate only to the last wholesale distributor in the chain. Sanofi has demonstrated that such "subset" was never intended and is purely a creature of administrative policy. Finally, in construing a statute, the statute and case law require that the courts adopt an interpretation that would not render the statute unconstitutional. Sanofi believes that the Department's interpretation and trial court's order result in the statute violating the Equal Protection and Due Process Clauses.

The trial court's summary judgment in favor of the Department should be reversed, its denial of Sanofi's motion for summary judgment should be reversed, and this court should find that the trial court erred when it failed to grant summary judgment to Sanofi.

RESPECTFULLY SUBMITTED this 18th day of December, 2017.

EISENHOWER CARLSON PLLC

By: _____

Garry G Fujita
Attorneys for Appellants Aventis Pharmaceutical, Inc. and Sanofi-Aventis US, LLC

CERTIFICATE OF SERVICE

The undersigned certifies under the penalty of perjury under the laws of the State of Washington that I am now and at all times herein mentioned a resident of the State of Washington, over the age of eighteen years, not a party to or interested in the above-entitled action, and competent to be a witness herein.

On the date given below, I caused to be served the foregoing document on the following persons and in the manner listed below:

Heidi Irwin
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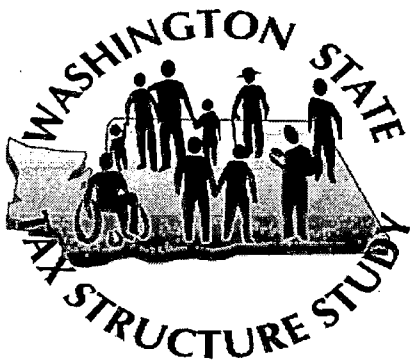
☒ U.S. MAIL
☐ E-SERVICE
☐ LEGAL MESSENGER
☒ E-MAIL
☐ FACSIMILE
☐ FEDEX, NEXT DAY

I hereby declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED at Tacoma, Washington this 18th day of December, 2017.

Cindy Rochelle
Cindy Rochelle

APPENDIX



Tax Alternatives for Washington State: A Report to the Legislature

Prepared Pursuant to
Chapter 7, Section 138, Laws of 2001

By the Washington State
Tax Structure Study Committee

William H. Gates Sr., Chair

Volume 1
Committee Report

November 2002

Chapter 4, page 24 (page 22 provided as a point of reference) at

https://dor.wa.gov/sites/default/files/legacy/Content/AboutUs/StatisticsAndReports/WAtaxstudy/Chapter_4.pdf

Chapter 4: Key Conclusions from the Evaluation of the Current Washington Tax Structure

Introduction

This chapter presents the key conclusions and the Committee's view based on the evaluation of the current Washington State tax structure. At the end of the report there is a section titled "Methodology and Detailed Conclusions" that describes the methodologies used in the measurement of the tax system and more details about the conclusions.

The following analysis systematically measures the tax system as well as each tax individually against the following principles: equity, neutrality, economic vitality, stability, adequacy, simplicity, transparency, home ownership, and harmony with the tax systems of other states.

The scope of analysis was determined by the requirements of Engrossed Substitute Senate Bill 6153, the statute which created this study, and by questions posed by the Technical Advisory Subcommittee, the Advisory Group, and the Governor's Competitiveness Council. Significant conclusions in this chapter are derived from the answers to these questions.

Conclusions from the Analysis Organized by Principle

Equity

Most people agree that fairness requires relative tax burdens on households (taxes as a percentage of household income) to be the same for all households, or higher for households with higher incomes (i.e., a progressive tax system). Correspondingly, a tax system that imposes higher relative burdens on households with lower incomes (i.e., a regressive tax system) is considered inequitable. Fairness in business taxation requires that similar businesses bear similar relative tax burdens.

The finding for the Washington State tax system is that there are inequities for households and businesses.

Despite these findings, surveys indicate that Washington's tax system would be perceived by the majority of businesses and individuals as being fair. Surveys of individuals in other states find that the sales tax is perceived to be the most equitable tax by a majority of survey respondents. A survey of Washington businesses shows that most businesses think that the Washington tax system does not hinder their ability to conduct business.

Neutrality

Neutrality requires that a tax system minimize the opportunities and incentives for taxpayers to alter their decisions in order to take advantage of differential tax treatment of economic activity.

The finding for the Washington State tax system is that it causes substantial non-neutralities for both businesses and households. The pyramiding of the B&O tax creates the main non-neutralities for businesses. Pyramiding of taxes is the payment of taxes by different companies on the same goods or services. This occurs when goods or services of one company are inputs for another's production and/or sales. Thus, a tax is paid multiple times on a product as it moves through the production chain.

The B&O tax pyramids an average of 2.5 times, but this rate varies considerably across industries. The B&O tax on many services pyramids at about 1.5 times, whereas for some types of manufacturers the rate of pyramiding is over five or six times. This causes effective B&O tax rates (the rate paid on the value added to goods and services by an enterprise) to vary considerably from industry to industry.

The tax system imposes non-neutral tax treatment of households because a significant fraction of consumer spending is untaxed. For example, certain types of spending, such as non-restaurant purchases of food and many consumer services, are not subject to the retail sales tax.

Economic Vitality

Economic vitality requires Washington State to offer a tax environment that is as conducive to firms choosing or maintaining their location in the state as that provided by states offering similar amenities. Likewise, the tax system should not impede businesses from expanding their operations in the state.

The finding is that Washington's tax system places a relatively high tax burden on low profit margin firms mainly because of the B&O tax. Due to the B&O tax, low profit margin firms and firms that are new or expanding may suffer a competitive disadvantage compared to their competitors in other states.

Firm location studies show that taxes matter in location decisions when other factors are equal. Business taxes are generally lower in Oregon. Since Washington and

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Appendices

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Appendix C, page 41 (page 5 provided as a point of reference) at

https://dor.wa.gov/sites/default/files/legacy/Content/AboutUs/StatisticsAndReports/WAtaxstudy/Appendix_C.pdf

Appendix C: Details of the Analysis

Appendix C-1

QUESTIONS RELATING TO TAX PRINCIPLES

The following questions were developed by the Committee and staff economists to direct the economic analysis of Washington's existing tax system.

In answering each of these questions the analysis will also answer further analytical questions such as: How much? Why? Is it getting better or worse? How do we compare to other states (where appropriate)?

Elasticity/Volatility

1) Do our tax revenues keep up with income?
   a) over the long run?
   b) during economic expansion?
   c) during economic downturns?

2) Have changes in our tax system such as exemptions, deductions and base broadening over the past ten years changed our elasticity?

3) Are our tax revenues stable?

Stability

1) Are our tax revenues predictable?

2) Is our tax system stable? If not, why not?

3) Has the rainy day fund been an effective tool for keeping the tax base stable?

4) How stable are the major local taxes?

5) How do changes in the state tax system affect the stability of local taxes?

Table 1
Effective Tax Rate on Value Added
Listed by Degree of Pyramiding

	t_i	V_i	Y_i	$\tilde{Y}_i$	Effective Tax Rate On Value Added	Degree of Pyramiding
			$Millions			
4 MFG FOOD 20	0.30%	2,506	5,814	5,864	2.03%	**6.7**
11 MFG PETROLEUM REFINING 29	0.46%	430	1,116	1,130	3.06%	**6.7**
19 MFG AIRCRAFT & PARTS 372	0.50%	8,002	18,779	18,989	2.63%	**5.3**
12 MFG RUBBER & PLASTICS 30	0.47%	458	917	927	2.03%	**4.3**
15 MFG PRIMARY METAL 33	0.48%	883	1,705	1,723	2.00%	**4.1**
5 MFG APPAREL & TEXTILES 22-23	0.47%	324	636	642	1.95%	**4.1**
6 MFG LUMBER & WOOD PROD 24	0.48%	2,688	5,293	5,345	1.92%	**4.0**
21 MFG PROF & SCIENTFC INSTR 38	0.46%	1,004	1,918	1,936	1.83%	**4.0**
17 MFG IND/COMM/COMP M&E 35	0.49%	1,626	3,199	3,230	1.90%	**3.9**
7 MFG FURN & FIXTURES 25	0.47%	212	398	402	1.76%	**3.7**
20 MFG OTHER TRANS EQUIP 37	0.50%	854	1,650	1,666	1.85%	**3.7**
8 MFG PAPER PROD 26	0.45%	1,490	2,648	2,673	1.66%	**3.7**
14 MFG STONE/CLAY/GLASS 32	0.46%	675	1,128	1,139	1.59%	**3.4**
10 MFG CHEMICAL PROD 28	0.47%	842	1,413	1,426	1.54%	**3.3**
3 CONSTRUCTION 15-17	0.48%	11,063	19,074	19,249	1.59%	**3.3**
18 MFG ELECT M&E (NOT COMP) 36	0.49%	1,429	2,295	2,314	1.38%	**2.8**
13 MFG LEATHER ETC 31	0.51%	21	34	34	1.42%	**2.8**
35 MOVIES/AMUSE/REC 78-79	0.82%	1,700	2,835	2,873	2.25%	**2.7**
34 SVC MISC REPAIR 76	0.51%	557	859	866	1.35%	**2.7**
22 MFG MISC MFG IND 39	0.44%	575	862	869	1.16%	**2.7**
9 MFG PRINT & PUBLISHING 27	0.52%	1,340	2,039	2,057	1.35%	**2.6**
23 TRANSPORTATION ETC 40-47	0.74%	6,051	9,583	9,694	1.84%	**2.5**
2 MINING/QUARRY 10-14	0.49%	420	600	605	1.17%	**2.4**
16 MFG FABRICATED METAL 34	0.47%	1,031	1,436	1,447	1.08%	**2.3**
29 SVC LODGING 70	0.49%	1,166	1,543	1,556	1.08%	**2.2**
30 SVC PERSONAL 72	0.95%	1,107	1,638	1,660	2.04%	**2.1**
1 AG FOR FISHING 1-9	0.69%	4,847	6,764	6,831	1.39%	**2.0**
33 SVC AUTO REPAIR,SERV 75	0.49%	1,732	2,245	2,261	0.96%	**2.0**
24 COMMUNICATIONS 48	0.61%	5,608	7,455	7,521	1.18%	**1.9**
26 WHOLESALE TRADE 50-51	0.46%	13,090	16,556	16,673	0.89%	**1.9**
37 LEGAL/ENG/ACCT 81-89	1.14%	9,966	13,817	14,023	2.07%	**1.8**
32 SVC BUSINESS 73	0.95%	3,487	4,516	4,571	1.58%	**1.7**
27 RETAIL TRADE 52-59	0.47%	17,614	20,535	20,668	0.75%	**1.6**
36 SVC MEDICAL & HEALTH 80	1.25%	9,801	12,563	12,755	1.95%	**1.6**
28 FIRE 60-67	0.95%	31,021	38,511	38,969	1.48%	**1.6**
25 ELECTRIC,GAS&OTHER UTIL 49	2.14%	2,852	3,716	3,808	3.22%	**1.5**
31 SVC COMP/DATA/PROC 737	0.91%	10,510	12,313	12,445	1.26%	**1.4**
Total State	0.61%	158,980	228,401	230,841	**1.53%**	**2.5**

Notes:

$\tilde{Y}_i$ = industry output including pyramided gross receipts taxes, calculated here.

Y_i = the original industry output vector, from the WA State Implan model.

V_i = value added, from the WA Implan model.

t_i = gross receipts tax rates calculated with actual DOR tax collections and tax base.

The estimated degree of pyramiding is the effective tax on value added divided by t_i .